INFORMATION BULLETIN

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Adjustments to Various Fiscal Measures

This information bulletin provides a detailed description of the changes made to certain fiscal measures. These changes, mostly of a technical nature, are designed to make the tax system more consistent and ensure its integrity.

The purpose of this information bulletin is also to empower the Minister of Revenue to pay financial compensation to certain elderly persons living in a residence or in rental housing.

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Finances Québec

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1. CLARIFICATION RELATING TO THE ELIMINATION OF SEPARATE QUÉBEC ELECTIONS AND TO THE MEASURE FOR THE SYNCHRONIZATION OF FISCAL PERIODS

On December 20, 2006, the ministère des Finances announced the elimination of many separate Québec elections,[1] noting that the objective of flexibility at the heart of this privilege had to be reviewed because it had been twisted for the purposes of tax planning schemes seeking to avoid provincial income tax.

Accordingly, it was indicated that the tax legislation would be amended to stipulate that where a valid election was made for the purposes of federal income tax, the same election would be deemed made for the purposes of Québec income tax and that where no valid election was made for the purposes of federal income tax, no election would be possible for the purposes of Québec income tax.

More specifically, the announcement mentioned a list of legislative provisions covered, noting that other items could be added to the list if need be. The provisions covered included the one allowing individuals to elect, under certain conditions, a fiscal period ending on a date other than December 31. If need be, such individuals would henceforth be required to synchronize their end of fiscal period date with the one chosen for the purposes of the federal legislation. The end of fiscal period date that should be used for the purposes of the Québec legislation would be, in accordance with the rule eliminating separate elections, the one chosen for the purposes of the federal legislation where, after December 19, 2006, they would have chosen an end of fiscal period date other than December 31.

In the same vein, it was announced, in the Budget Speech of March 13, 2008, that the tax legislation would be amended to ensure that a corporation's end of fiscal period date be synchronized with the one it has chosen for the purposes of the federal legislation.

The purpose of this amendment is to require synchronization of all fiscal periods of corporations whose end date was different from that chosen for the purposes of the federal legislation.

While the fiscal period synchronization requirement announced as part of the Budget Speech of March 13, 2008 applies to every corporation, the synchronization resulting from the elimination of separate elections announced on December 20, 2006, applies only to individuals who elected after December 19, 2006, a fiscal period ending on a date other than December 31.

To ensure even application of the fiscal period synchronization rule announced in the Budget Speech of March 13, 2008 and to dispel any doubt, it is specified today that this rule will apply not only to corporations and to partnerships, but also to every category of taxpayers.

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1 Information Bulletin 2006-6, p. 10.

The tax legislation will therefore be amended accordingly and this amendment will apply as of December 20, 2006.

Under the circumstances, all taxpayers concerned will have to synchronize their end of fiscal period date with the one chosen under the federal legislation, according to the same terms and conditions as those previously announced as part of the Budget Speech of March 13, 2008.

2. ADJUSTMENT RELATING TO ELIGIBILITY FOR THE SME GROWTH STOCK PLAN

The SME Growth Stock plan (Accro PME) is a capitalization assistance plan designed to make it easier for eligible small public corporations, or those on the way to becoming eligible, to raise permanent capital by allowing shareholders of these corporations, within the limits stipulated by the legislation, to deduct, in calculating their taxable income, the acquisition cost of treasury shares acquired under the plan.

In addition, while in general, the rules of the Accro PME plan do not govern the use of the capital obtained under the plan, they do prohibit using the proceeds of an issue to pay for the acquisition of shares or any other negotiable security of a corporation. However, this prohibition includes an exception where, briefly, shares or negotiable securities of a corporation are acquired for the expansion of an issuing corporation through the acquisition of another corporation whose activities give rise to a commercial interest having a direct link with its own activities and that, after its acquisition, will be a controlled subsidiary of the issuing corporation (rules concerning the acquisition of a controlled subsidiary).

To qualify as an eligible issuing corporation under this plan, a corporation must satisfy various requirements. Since the Accro PME plan is geared to corporations that are part of a specific market segment, one of these requirements bears on the size of the issuing corporation. According to this requirement, the value of the assets of an eligible issuing corporation must not exceed $100 million, calculated on a consolidated basis with the assets of any corporation associated with it ($100 million rule).

The concept of associated corporation is used for various purposes in the tax legislation. Briefly, the notion of control is central to the concept under which corporations that maintain, in law or in fact, a certain proximity among themselves can be considered as being part of the same economic group. For example, two corporations are associated with each other where one controls the other.

Furthermore, the legislation stipulates various rules for determining whether corporations are associated with each other. In particular, a rule is stipulated according to which, briefly, the right or option, conditional or not, of a person to acquire shares of a corporation must be treated as though such right or such option had been exercised (rights or options rule).

For example, where a corporation (the Corporation) reaches an agreement in principle, conditional on various requirements being satisfied, for the acquisition of the shares of another corporation (the Target), the result is that the two corporations are associated even before the acquisition becomes effective. In such a case, to determine whether the two corporations are associated with each other, the theoretical shareholder structure of the Target must be established considering that the Corporation exercised its right of acquisition, thus resulting in the association of the two corporations. In this context, if the Corporation wished to participate in the Accro PME to fund the acquisition of shares of the Target, it would have to, for the purposes of the $100 million rule, add the value of the Target's assets to the value of its assets, thus leading to a form of "prior consolidation" of the value of the assets of the two corporations.

Moreover, with regard to business acquisition, it is common for the parties to protect themselves and prove the seriousness of their intentions by signing an agreement in principle that stipulates requirements that must be satisfied to give practical effect to the projected acquisition (acquisition agreement), notably because of the costs incurred in the study of a proposed acquisition and the preparation of the financial package to act on it.

Accordingly, as illustrated above, the rights or options rule applies to an acquisition agreement to establish an association link between a potential buyer and a possible target. In the context of the Accro PME plan, this association link results in the "prior consolidation" of the respective value of the assets of the parties, thus reducing the ability of the potential buyer to comply with the $100 million rule.

Given that the rules of the Accro PME specifically stipulate the possibility that a corporation may use this plan to acquire a controlled subsidiary and that the effects of the rights or options rule explained above can reduce the ability of the potential buyer to comply with the $100 million rule, it is appropriate to conclude that the rights or options rule does not correspond to the objective of the rules concerning the acquisition of a controlled subsidiary. Consequently, it is appropriate to limit the application of the rights or options rule in measuring the size of an issuing corporation under the Accro PME plan.

More specifically, an exception will be added to the legislation so that, in the course of examining the eligibility of an issuing corporation for the Accro PME plan, the value of the assets of the issuing corporation will be determined without taking into account the value of the assets of corporations whose association with the issuing corporation results exclusively from the application of the rights or options rule in the context of the application of the rules concerning the acquisition of a controlled subsidiary.

This change will apply regarding a public offering of shares for which the receipt for the final prospectus, or the filing exemption, as the case may be, is granted after the day of publication of this information bulletin.

3. SIMPLIFICATION OF THE DEDUCTION FOR RENOVATIONS OR ALTERATIONS TO IMPROVE ACCESS TO A BUILDING

The tax legislation allows a taxpayer to deduct, in calculating his business or property income, the portion of the amount he paid in the year for renovations or alterations made to a building he uses mainly to earn such income, regarding which he holds an eligibility certificate issued by the Régie du bâtiment du Québec certifying that the renovations or alterations incorporate the obstacle-free design standards stated in the Québec *Construction Code*.

Currently, the Régie du bâtiment issues such an eligibility certificate essentially on the basis that an architect, engineer or professional technologist has certified, on the authorized form, that the work was carried out in accordance with the design standards in question.

Under these circumstances, a taxpayer wishing to claim this deduction must, first, approach an architect, engineer or professional technologist to obtain certification that the work complies with the obstacle-free design standards and, second, obtain the eligibility certificate from the Régie du bâtiment.

To simplify the formalities required to claim the deduction for renovations or alterations, the tax legislation will be amended such that the Régie du bâtiment's involvement will no longer be necessary to be entitled to this deduction.

Consequently, a taxpayer may be entitled to the deduction for renovations or alterations provided an architect, engineer or professional technologist certifies, on a prescribed form, that the renovation or alteration work was carried out in accordance with the obstacle-free design standards set out in the Québec *Construction Code*.

This amendment will apply regarding renovation or alteration expenses incurred after March 23, 2006, the date of the introduction of this deduction.

4. DEFERRAL OF TAXATION OF AN ELIGIBLE REBATE FOR CERTAIN DISPOSITIONS

To encourage the development an capitalization of Québec cooperatives, the current tax legislation stipulates the deferral of taxation of a rebate that consists of preferred units issued by an eligible cooperative.

Briefly, a taxpayer who is a member of an eligible cooperative can deduct, in calculating his taxable income, the amount of an eligible rebate attributed to him consisting of a preferred unit of such cooperative. Upon the disposition of such preferred unit, the member must include, in calculating his taxable income, the amount of the deduction for rebate he claimed in relation to the unit disposed of.

However, where the disposition of a preferred unit for which a deduction for eligible rebate was allowed results from the merger or the winding-up of the eligible cooperative that attributed such preferred unit, the deferral of taxation of the eligible rebate is maintained until the time of subsequent disposition of the preferred unit attributed by the new cooperative replacing the initial unit.

This exception stipulates the maintenance of the deferral of taxation of the rebate since, in spite of the merger of the cooperative or its winding-up, this type of reorganization of the cooperative nonetheless enables the member who disposed of a preferred unit of the cooperative to continue holding a preferred unit in the capital of the new cooperative.

In the same vein, a capital reorganization or a conversion of units of a cooperative constitute operations whose objective, generally, is to adjust the capital structure of a cooperative without reducing its capitalization, and to preserve the membership of the persons who were members of the cooperative before the capital restructuring.

In this context, the same exception as stipulated concerning the disposition of a preferred unit that arises in the course of a merger of a cooperative or its winding-up will be allowed regarding a preferred unit that is disposed of in the course of a capital reorganization or a conversion of units of a cooperative.

More specifically, the tax legislation will be amended so that the disposition of a preferred unit regarding which a deduction for eligible rebate has been allowed will no longer end the deferral of taxation of the rebate, where such disposition occurs in the course of a capital reorganization or the conversion of units of the eligible cooperative that issued the preferred unit. The deferral of taxation of the rebate will apply up to the time of subsequent disposition of the preferred unit issued by the cooperative replacing the initial unit.

This amendment will apply regarding the disposition of a preferred unit of a cooperative that occurs after the day of publication of this information bulletin.

5. NON-APPLICATION OF PENALTIES RELATING TO THE REDEMPTION OF A SECURITY ELIGIBLE FOR THE COOPERATIVE INVESTMENT PLAN IN THE CASE OF CERTAIN CAPITAL RESTRUCTURINGS

For more than twenty years, the government has supported the capitalization efforts of cooperatives[2] by granting, through the Cooperative Investment Plan (CIP), a tax benefit to individuals who acquire securities issued by an eligible cooperative.

In the March 30, 2004 Budget Speech, a major overhaul of this plan was announced, leading to the formation of a new CIP.

In addition to directing capitalization assistance to cooperatives that genuinely need it, and that have a substantial presence in Québec, the new CIP improves the permanence of capital raised with tax assistance.

A security issued under the new CIP cannot be redeemed or repaid before the expiry of a period of five years starting on the date it is issued, other than in exceptional circumstances where the redemption or repayment of the security is then allowable.[3]

In the event that a cooperative redeems or repays a security within the five-year period beginning on the date it is issued, and where such redemption or repayment is not allowable, it incurs a penalty equal to 30% of the amount of the security thus redeemed or repaid.[4]

Even prior to its overhaul, the CIP included rules to ensure a degree of permanence of capital raised with tax assistance.

Indeed, a security issued by an eligible cooperative pursuant to the rules of the CIP prior to the overhaul of the plan,[5] hereunder called "former CIP", cannot, generally speaking, be redeemed before the year following the two years that follow the year it is issued, provided the amount of the reserve shown in the financial statements[6] of the cooperative at the end of the last fiscal period preceding the redemption has risen by at least 50% of the amount of the redemption, taking previous redemptions into account, compared with the amount of the reserve shown in the financial statements of the cooperative at the end of the last fiscal period preceding the issue.

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2 For the sake of readability, any reference to a cooperative must also be read as a reference to a federation of cooperatives.

3 In general, the redemption or repayment of a security is allowable within the five-year period beginning on the date of its issue by a cooperative, where it occurs because of the death of the holder of the security or because of his resignation or exclusion as a member of the cooperative or, if he is an employee of the cooperative, the termination of his employment or his disability.

4 However, the penalty is eased in a situation of winding-up or dissolution of a cooperative.

5 Securities could be issued pursuant to these rules until December 31, 2004.

6 Any reference to an amount of the reserve shown in the financial statements includes, as the case may be, the amount of the enhancement reserve.

Should a cooperative redeems securities issued pursuant to the rules of the former CIP without satisfying the requirements of the plan, it incurs a penalty equal to 50% of the amount of the securities thus redeemed.

There are situations where the redemption of securities issued by a cooperative under the CIP has no impact on the contribution of capital relating to such securities. Such situations, which often follow decisions taken in the course of a cooperative's business, occur in particular where securities issued under the new or the former CIP are redeemed to be cancelled and replaced with new securities having similar characteristics.

Accordingly, so that certain types of restructuring affecting the share capital of a cooperative are not hampered by the application of either of the penalties relating to the redemption of a security issued under the CIP, the tax legislation will be amended to make these penalties inapplicable regarding a cooperative that redeems or repays a security issued under a "recognized exchange operation".

To this end, a "recognized exchange operation" means an operation, consisting of a recapitalization, a conversion of securities or a merger, under which:

— any outstanding security issued under the new CIP is exchanged for consideration consisting solely of preferred units or fractions of such units that satisfy the requirements stipulated in paragraphs 3° and 4° of section 6 of the *Cooperative Investment Plan Act*;

— any outstanding security issued under the former CIP is exchanged for consideration consisting solely of preferred units or fractions of such units that satisfy the requirements stipulated in paragraphs 3° and 5° of section 6 of the rules of the Cooperative Investment Plan adopted under the *Act respecting the ministère du Développement économique, de l'Innovation et de l'Exportation*.

In addition, any preferred unit (including any fraction of such unit) that is received under such an operation in exchange for a security issued under the CIP is deemed to be the same security as the exchanged security and to continue it, for the purposes:

— either of the *Cooperative Investment Plan Act* and the fiscal measures relating thereto, in the case where the exchanged security was issued under the new CIP;

— or of the rules of the Cooperative Investment Plan adopted under the *Act respecting the ministère du Développement économique, de l'Innovation et de l'Exportation* and the fiscal measures relating thereto, in the case where the exchanged security was issued under the former CIP.

These changes will apply regarding a recapitalization, conversion of securities or merger carried out after the day of publication of this information bulletin.

6. THE MINISTER OF REVENUE EMPOWERED TO PAY FINANCIAL COMPENSATION TO CERTAIN ELDERLY PERSONS LIVING IN A RESIDENCE OR IN RENTAL HOUSING

To facilitate home support of elderly persons age 70 or over and thus avoid or delay their lodging in the public health and social services network, the tax system grants them financial assistance consisting of a refundable tax credit.

Following the March 13, 2008 Budget Speech, many of the parameters of this tax credit were changed to simplify its application, increase the assistance it provides for elderly persons and direct this assistance to persons who need it most.

Accordingly, besides the fact that, since 2008, the rate of the tax credit has risen from 25% to 30%, that the annual cap on eligible expenses applicable to an elderly person has been raised from $15 000 to $15 600 ($21 600 if the person is dependent) and that the tax credit reduces according to family income in excess of $50 000, the method of determining the eligible expenses included in the rent has been simplified for persons living in a residence for elderly persons or in an apartment building.

While the vast majority of seniors who already received this tax credit before the day of the budget benefit from these changes, it is possible that, for some, the tax credit may be less than the amount they received in advance. In particular, this situation could occur in cases where the amount paid in advance was too high because of difficulties certain managers of seniors' residences experience in determining the expenses eligible for the tax credit.

Since many seniors might find it impossible to pay their rent in full should the amounts they used to receive in advance be reduced, the Budget Speech stipulated the implementation of a transitional financial compensation program.

Under this program, low-income persons living in a seniors' residence or other apartment building can receive non-taxable financial compensation in the event that the application of the new rules results, in their case, in a decline in tax assistance compared with what they received in advance regarding the eligible expenses included in the rent payable prior to March 14, 2008.

Revenu Québec was given responsibility for administering this transitional financial compensation program, whose application details are to be released by the Minister of Revenue.

Under the current legislation, besides the fact that the Minister of Revenue is charged with the management and administration of his department, he is essentially responsible for enforcing various statutes and agreements, most of which are of a tax nature. However, he is not empowered to implement a financial assistance program.

Accordingly, to explicitly empower the Minister of Revenue to grant financial compensation to elderly persons affected by the changes that were made to the refundable tax credit for home support of an elderly person, the tax legislation will be amended to stipulate that the Minister of Revenue may formulate and implement a transitional financial assistance program for elderly persons living in a residence or in rental housing that will apply as of January 1, 2008.

This empowerment will take effect as of the day of publication of this information bulletin.

Moreover, to facilitate the administration by Revenu Québec of the transitional financial compensation program, the *Act respecting the ministère du Revenu* will be amended to stipulate that, as of taxation year 2008, the program will be considered as a fiscal law for the purposes of the Act and its regulations.